

RECOM MANAGED SYSTEMS INC DE/
Form SB-2
January 26, 2005

As filed with the Securities and Exchange Commission on January 26, 2005

Commission File No. 333 _____

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

**Form SB-2
Registration Statement Under The Securities Act Of 1933**

Recom Managed Systems, Inc.
(Name of small business issuer in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	3845 (Primary Industrial Code)	87_0441351 (I.R.S. Employer Identification No.)
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Marvin H. Fink
Chief Executive Officer
4705 Laurel Canyon Boulevard, Suite 203
Studio City, California 91607
(818) 432-4560

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

(Name, address, including zip code, and telephone number, including area code, of agent for service of process)

Copies to

John M. Woodbury, Jr., Esq.
358 Patterson Blvd. SW
Calgary, Alberta T3H 3K1
Telephone (403) 217-5532

Approximate date of proposed sale to public: As soon as practicable after the effective date of this registration statement.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box:

If this Form is a post effective amendment filed pursuant to Rule 462(c) under the Securities Act of 1933, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: _____

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act of 1933, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: _____

If delivery of this prospectus is expected to be made pursuant to Rule 434, please check the following box:

Calculation of Registration Fee

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Offering Price Per Share (1)	Proposed Aggregate Offering Price	Amount of Registration Fee
Common stock (2)	380,952(3)	\$ 3.80	\$ 1,447,618	\$ 387.82
Common stock (4)	275,000(5)	\$ 3.80	\$ 1,045,000	\$ 279.96
Common stock (6)	380,952(7)	\$ 3.80	\$ 1,447,618	\$ 387.82
Common stock (8)	131,377(10)	\$ 3.80	\$ 499,233	\$ 133.74
Common stock (9)	200,000(10)	\$ 3.80	\$ 760,000	\$ 203.60
Total	1,368,281		\$ 5,199,469	\$ 1,392.94

- (1) Estimated solely for the purpose of calculating the registration fee pursuant to SEC Rule 457(c) of Regulation C as of the close of the market on January 18, 2005, based upon the average of the high and low prices for that date.
- (2) Represents common stock reserved for issuance by the registrant with respect to the prospective conversion of a convertible debenture issued on December 29, 2004 at the election of the holder of that debenture.
- (3) Pursuant to SEC Rule 416(a), also covers additional common shares that may be offered as a result of stock splits, stock dividends or similar transactions relating to these shares, including standard weighted-average and other anti-dilution protective provisions contained in the underlying convertible debenture.
- (4) Represents common stock reserved for issuance by the registrant with respect to the prospective exercise of common stock purchase warrants granted to the holder of the aforesaid debenture in connection with the sale of that debenture by the registrant.
- (5) Pursuant to SEC Rule 416(a), also covers additional common shares that may be offered as a result of stock splits, stock dividends or similar transactions relating to these shares, including standard weighted-average and other anti-dilution protective provisions contained in the underlying common share purchase warrant.
- (6) Represents a pool of common stock reserved for issuance by the registrant with respect to any of the following: (1) the prospective conversion, at the election of the registrant, of principal under the aforesaid convertible debenture at a lower conversion price than that afforded to the debenture holder; or (2) the prospective payment by the registrant in the form of common stock of interest, penalties and/or damages that may accrue under the debenture and/or warrants.
- (7) Pursuant to SEC Rule 416(a), also covers additional common shares that may be offered as a result of stock splits, stock dividends or similar transactions relating to these shares, including standard weighted-average and other anti-dilution protective provisions contained in the underlying convertible debenture and/or common share purchase warrants.
- (8) Represents common stock reserved for issuance by the registrant with respect to the prospective conversion of 200,000 series A preferred shares issued as a dividend payable in kind in satisfaction of dividends accrued through December 31, 2004 on series A preferred shares then outstanding.
- (9) Represents a pool of common stock reserved for issuance by the registrant with respect to the prospective issuance and conversion of up to 200,000 additional series A preferred shares as a dividend payable in kind in satisfaction of dividends that may accrue after December 31, 2004 on series A preferred shares then outstanding.
- (10) Pursuant to SEC Rule 416(a), also covers additional common shares that may be offered as a result of stock splits, stock dividends or similar transactions relating to these shares, including standard weighted-average and other anti-dilution protective provisions contained in the certificate of designation underlying the series A preferred shares.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until

this registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

PRELIMINARY PROSPECTUS SUBJECT TO COMPLETION, DATED JANUARY 26, 2005

The information in this prospectus is not complete and may be changed. We have filed a registration statement containing this prospectus with the Securities and Exchange Commission. The common stock offered for sale under this prospectus may not be offered for sale or sold until that registration statement is declared effective by the Securities and Exchange Commission. This prospectus is not an offer to sell the common shares and doesn't solicit an offer to purchase the common shares in any jurisdiction where this offer or sale is not otherwise permitted.

Prospectus

1,368,281 Common Shares

This prospectus relates to the offer and sale by some of our securities holders during the period in which the registration statement containing this prospectus is effective of up to 1,368,281 common shares, consisting of:

- 1,036,904 common shares reserved for issuance by the company in connection with the sale of a \$2,000,000 convertible debenture to DKR SoundShore Oasis Holding Fund Ltd. as follows:
 - o 380,952 common shares issuable by the company upon the prospective conversion, at the election of the debenture holder, of the full \$2,000,000 in principal due under the debenture;
 - o 275,000 common shares issuable by the company with respect to the prospective exercise of 275,000 common share purchase warrants issued to the debenture holder in connection with the sale of the debenture; and
 - o an additional pool of 380,952 common shares issuable by the company with respect to any of the following: (1) the prospective conversion, at the election of the company, of principal under the aforesaid convertible debenture at a lower conversion price than that afforded to the debenture holder; and/or (2) the prospective payment by the company in the form of common shares of interest, penalties and/or damages that may accrue under the debenture and/or warrants; and
- 331,377 common shares reserved for issuance by the company in connection with dividends paid or payable in kind with respect to the company's series A preferred shares sold in a private placement in fiscal 2003 as follows:
 - o 131,377 common shares issuable by the company with respect to the prospective conversion of 131,377 series A preferred shares issued as a dividend payable in kind in satisfaction of dividends accrued through December 31, 2004 on series A preferred shares then outstanding; and

o an additional pool of 200,000 common shares issuable by the company with respect to the prospective issuance and conversion of up to 200,000 additional series A preferred shares as a dividend payable in kind in satisfaction of dividends that may accrue after December 31, 2004 on series A preferred shares then outstanding.

This offering is not being underwritten. The common shares offered under this prospectus may be sold by the selling shareholders on the public market, in negotiated transactions with a broker-dealer or market maker as principal or agent, or in privately negotiated transactions not involving a broker or dealer. We will not receive any of the proceeds from those sales.

Our common shares trade on the Over-The-Counter Bulletin Board, also called the OTCBB, under the trading symbol RECM .

An investment in the common shares offered for sale under this prospectus involves a high degree of risk. See Risk Factors beginning on page 6 of this prospectus.

Neither the United States Securities and Exchange Commission nor any state securities commission has approved or disapproved of the common shares offered for sale under this prospectus or the merits of that offering, or has determined that this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is _____, 2005

**4705 Laurel Canyon Boulevard, Suite 203, Studio City, California 91607
(818) 432-4560**

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PROSPECTUS SUMMARY

This summary highlights important information about our company and business. Because it is a summary, it may not contain all of the information that is important to you. To understand this offering fully, you should read this entire prospectus and the financial statements and related notes included in this prospectus carefully. Unless the context requires otherwise, *Recom*, *we*, *us*, *our* and similar terms refer to Recom Managed Systems, Inc.

On April 11, 2003, we effected a split in our common shares on a 3:1 forward basis through the mechanism of a stock dividend. Whenever we make any reference in this prospectus to the grant or issuance of common shares or options or warrants to purchase common shares, such reference shall, for comparison purposes, be made in reference to post-split numbers and, in the case of options and warrants, exercise prices, unless we state otherwise.

The Company And Business

Recom is a development stage medical device company focused on researching, developing and marketing medical devices which monitor and measure physiological signals in order to detect diseases that impact an individual's health. Physiological signals are small bioelectrical signals generated by the body. Our initial product will be patient modules used as part of a heart monitor system to acquire, amplify and process physiological signals associated with a patient's cardiovascular system. Heart monitor systems are used by heart specialists known as cardiologists to collect physiological data for electrocardiogram or ECG tests for the purpose of detecting and identifying cardiovascular disease. Our patient module will operate using a proprietary and patented amplification technology which provides the capability to enlarge and process the physiological signals to discriminate them from ambient or background electromagnetic noise and to facilitate the examination of the signal data for diagnostic purposes. Our amplification technology is an enhancement of an amplification technology first developed for the United States Air Force to record bioelectrical signals from a pilot's brain, known as an electroencephalogram or EEG. The technology was also used by the National Institute of Health as well as companies such as Titan Systems and Teledyne, Inc. for purposes of monitoring different physiological signals.

In December 2004, we completed the design, fabrication and testing of a pre-production model of our first product for commercialization, our battery-operated, digital 12-lead Recom Model 100 Patient Module or *Model 100 Module*. The Model 100 Module will be used as the primary component of a 12-lead ambulatory heart monitor system, referred to as the *Model 100 Monitor System*. The Model 100 Monitor System is an ambulatory patient heart monitor or recording system that will allow a patient's heart to be continuously monitored over a period of 24 to 48 hours while the patient carries out his or her daily activities away from the physician's office or hospital. We anticipate that we will introduce our Model 100 Monitor System to the market at the American College of Cardiology Convention to be held in March, and will start selling the devices in late 2005.

As of January 6, 2005, we had issued and outstanding 34,860,068 common shares, 377,719 series A preferred shares, and common share purchase options and warrants entitling the holders to purchase up to 4,681,395 common shares.

Our corporate offices are located at 4705 Laurel Canyon Boulevard, Suite 203, Studio City, California 91607. Our telephone number is (818) 432-4560.

The Offering

This prospectus relates to the offer and sale by some of our securities holders during the period in which the registration statement containing this prospectus is effective of up to 1,368,281 common shares, consisting of:

- 1,036,904 common shares reserved for issuance by the company in connection with the sale of a \$2,000,000 convertible debenture to DKR SoundShore Oasis Holding Fund Ltd. as follows:

- o 380,952 common shares issuable by the company upon the prospective conversion, at the election of the debenture holder, of the full \$2,000,000 in principal due under the debenture;
- o 275,000 common shares issuable by the company with respect to the prospective exercise of 275,000 common share purchase warrants issued to the debenture holder in connection with the sale of the debenture; and

- o an additional pool of 380,952 common shares issuable by the company with respect to any of the following: (1) the prospective conversion, at the election of the company, of principal under the aforesaid convertible debenture at a lower conversion price than that afforded to the debenture holder; and/or (2) the prospective payment by the company in the form of common shares of interest, penalties and/or damages that may accrue under the debenture and/or warrants; and
- 331,377 common shares reserved for issuance by the company in connection with dividends paid or payable in kind with respect to the company's series A preferred shares sold in a private placement in fiscal 2003 as follows:
 - o 131,377 common shares issuable by the company with respect to the prospective conversion of 131,377 series A preferred shares issued as a dividend payable in kind in satisfaction of dividends accrued through December 31, 2004 on series A preferred shares then outstanding; and
 - o an additional pool of 200,000 common shares issuable by the company with respect to the prospective issuance and conversion of up to 200,000 additional series A preferred shares as a dividend payable in kind in satisfaction of dividends that may accrue after December 31, 2004 on series A preferred shares then outstanding.

The common shares offered under this prospectus may be sold by the selling shareholders on the public market, in negotiated transactions with a broker-dealer or market maker as principal or agent, or in privately negotiated transactions not involving a broker or dealer. Information regarding the selling shareholders, the common shares they are offering to sell under this prospectus, and the times and manner in which they may offer and sell those shares is provided in the sections of this prospectus captioned *Selling Shareholders*, *Registration Rights* and *Plan of Distribution*. We will not receive any of the proceeds from those sales. Should the selling shareholders in their discretion exercise any of the common share purchase warrants or options underlying the common shares offered under this prospectus, we would, however, receive the exercise price for those warrants. The registration of common shares pursuant to this prospectus does not necessarily mean that any of those shares will ultimately be offered or sold by the selling shareholders, or that any of the common share purchase warrants or options underlying the common shares offered under this prospectus will be exercised.

Summary Financial Data

The following tables summarize the consolidated statements of operations and balance sheet data for our company for the periods or as of the dates indicated, respectively:

	Nine-Month Interim		Year Ended	
	Period Ended		December 31,	
	September 30,		2002	
	2004	2003	2003	2002
Consolidated Statements of Operations Data:				
Revenue	\$	\$	\$	\$
Research and development expenses	\$ (880,523)	\$ (166,910)	\$ (497,631)	\$ (67,500)
General and administrative expenses	\$ (3,905,983)	\$ (3,262,176)	\$ (4,813,746)	\$ (144,454)
Net loss	\$ (4,786,506)	\$ (3,429,086)	\$ (5,311,377)	\$ (211,954)
Preferred dividend	\$ (246,962)	\$	\$ (1,953,170)	\$
Net loss attributed to common stockholders	\$ (5,033,468)	\$ (3,429,086)	\$ (7,264,547)	\$ (211,954)
Basic and diluted loss per share	\$ (0.14)	\$ (0.11)	\$ (0.17)	\$ (0.02)
Basic and diluted loss per share attributed to common stockholders	\$ (0.15)	\$ (0.11)	\$ (0.23)	\$ (0.02)

Weighted average shares outstanding, basic and diluted	33,419,220	31,524,884	31,765,404	11,609,162
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	September 30, 2004	December 31, 2003
Consolidated Balance Sheet Data:		
Current assets	\$ 1,621,802	\$ 4,088,469
Total assets	\$ 2,042,105	\$ 4,415,596
Current liabilities	\$ 476,520	\$ 590,856
Total liabilities	\$ 476,520	\$ 590,856
Total stockholders' equity	\$ 1,565,585	\$ 3,824,740
Total liabilities and stockholders' equity	\$ 2,042,105	\$ 4,415,596

RISK FACTORS

An investment in our common shares involves a high degree of risk and is subject to many uncertainties. These risks and uncertainties may adversely affect our business, operating results and financial condition. In such an event, the trading price for our common shares could decline substantially, and you could lose all or part of your investment. In order to attain an appreciation for these risks and uncertainties, you should read this prospectus in its entirety and consider all of the information and advisements contained in this prospectus, including the following risk factors and uncertainties.

Risks Relating To Our Business

Our limited operating history will make it difficult for you to predict our future operating results and to otherwise assess or predict the likelihood of our business success.

To date, we are a development stage company principally engaged in research and development, organizational and startup activities which has not yet introduced our heart monitoring products to market. Our limited operating history will make it difficult, if not impossible, to predict future operating results and to assess the likelihood of our business success in considering an investment in our company. Risks and issues inherent in the establishment and expansion of a new business enterprise which we face include, among others, problems of entering new markets, marketing new technologies, hiring and training personnel, acquiring reliable facilities and equipment, and implementing operational controls. As a development stage company, we are also subject to risks and or levels of risk that are often greater than those encountered by companies with established operations and relationships. Development stage companies often require significant capital from sources other than operations. Since we are a start-up business, our management and employees will shoulder the burdens of the business operations and a workload associated with company growth and capitalization that is disproportionately greater than that for an established business. We cannot give you any assurance that we will successfully address these risks. Our prospects must be considered speculative, which may limit our ability to encourage further investment in our company.

We have no revenues to date and have accumulated losses since our inception. Our continued inability to generate revenues and profits could cause us to go out of business.

We have incurred cumulative net losses after preferred dividends available to common shareholders in the amount of \$12,596,642 from our inception through September 30, 2004. We have no commercial product sales or revenues to date, and do not anticipate that we will commence commercial sales of our heart monitoring products until the end of fiscal 2005. Once we commence marketing our heart monitoring products, we project that we will not be cash flow positive based solely on projected sales and service revenues less manufacturing, general and administrative, marketing expenses and other operating costs for an indefinite period of time. We anticipate that we will continue to incur substantial operating losses for the foreseeable future, notwithstanding any anticipated revenues we may receive when our products are initially introduced to markets, due to the significant costs associated with the development and marketing of our products and services.

If we are unable to raise additional working capital, we will be unable to fully fund our operations and to otherwise execute our business plan, leading to the reduction or suspension of our operations and ultimately our going out of business.

As of the date of this prospectus and assuming the full conversion of an outstanding debenture in the amount of \$2,000,000 into common shares, we will have sufficient cash on hand to our anticipated costs through June 2005, although this coverage could be less than that period as the result of changes in our anticipated level of operations, higher than expected costs such as through an acquisition of new products, or changes in our business plans. As noted in the prior risk factor, we do not anticipate that we will commence commercial sales of our heart monitoring products

until the end of fiscal 2005, and further anticipate that after such introduction we will continue to be cash flow negative due to our costs exceeding our revenues for an indefinite period of time. Based upon the foregoing, we will need to raise additional cash and working capital to cover an expected shortfall in our cash and working capital until such time, if any, as we become cash-flow positive. We currently do not have any binding commitments for, or readily available sources of, additional financing. Should we determine it to be necessary to raise additional cash in the future as our current cash and working capital resources are depleted, we will seek to raise it through the public or private sales of debt or equity securities, the procurement of advances on contracts or licenses, funding from joint-venture or strategic partners, debt financing or short-term loans, or a combination of the foregoing. We may also seek to satisfy indebtedness without any cash outlay through the private issuance of debt or equity securities. We cannot give you any assurance that we will be able to secure the additional cash or working capital we may require to continue our operations.

Even if we are able to raise additional financing, we might not be able to obtain it on terms that are not unduly expensive or burdensome to the company or disadvantageous to our existing shareholders.

Even if we are able to raise additional cash or working capital through the public or private sale of debt or equity securities, the procurement of advances on contracts or licenses, funding from joint-venture or strategic partners, debt financing or short-term loans, or the satisfaction of indebtedness without any cash outlay through the private issuance of debt or equity securities, the terms of such transactions may be unduly expensive or burdensome to the company or disadvantageous to our existing shareholders. For example, we may be forced to sell or issue our securities at significant discounts to market, or pursuant to onerous terms and conditions, including the issuance of preferred stock with disadvantageous dividend, voting or veto, board membership, conversion, redemption or liquidation provisions; the issuance of convertible debt with disadvantageous interest rates and conversion features; the issuance of warrants with cashless exercise features; the issuance of securities with anti-dilution provisions; and the grant of registration rights with significant penalties for the failure to quickly register. If we raise debt financing, we may be required to secure the financing with all of our business assets, which could be sold or retained by the creditor should we default in our payment obligations. We also might be required to sell or license our products or technologies under disadvantageous circumstances we would not otherwise consider, including granting licenses with low royalty rates and exclusivity provisions.

Our products are highly regulated. We will not be able to introduce our products to market if we cannot obtain the necessary regulatory approvals. If we are unable to obtain regulatory approvals for our products in selected key markets at all or in a timely manner, we will not be able to grow as quickly as expected, and the loss of anticipated revenues will also reduce our ability to fully fund our operations and to otherwise execute our business plan. Our failure to receive the regulatory approvals in the United States would likely cause us to go out of business.

The manufacture, sale, promotion and marketing of our heart monitoring products and other products we intend to develop are subject to regulation by the FDA and similar government regulatory bodies in other countries. As we develop or obtain new products we will be required to determine what regulatory requirements, if any, we must comply with in order to market and sell our products in the United States and worldwide. The process of obtaining regulatory approval could take years and be very costly, if approval can be obtained at all. If we fail to comply with these requirements, we could be subjected to enforcement actions such as an injunction to stop us from marketing the product at issue or a possible seizure of our assets. We intend to work diligently to assure compliance with all applicable regulations that impact our business. We can give you no assurance, however, that we will be able to obtain regulatory approval for all of our products. We also cannot assure you that additional regulations will not be enacted in the future that would be costly or difficult to satisfy.

Because we are not diversified, we are subject to a greater risk of going out of business should our single proposed product line fail.

The only business opportunities we are presently pursuing are the heart monitoring or ECG market and, later, using the same technology, the neurological brain scan or EEG market. Unlike many established companies that are diversified, we do not presently have other businesses, properties, investments or other income producing assets upon which we could rely upon should our single product line fail, thereby increasing the risk of our going out of business.

Many of our customers will rely upon third party reimbursements from third party payors to cover all or a portion of the cost of our products. If third party payors do not provide reimbursement for our products, we will not be able to grow as quickly as expected, and the loss of anticipated revenues will also reduce our ability to fully fund our operations and to otherwise execute our business plan.

We intend to sell our heart monitoring products to individual patients and doctors, hospitals and clinics who will seek reimbursement from various third party payers, including government health programs, private health insurance plans, managed care organizations and other similar programs. We can give you no assurance that reimbursement will be available from third party payers at all, or for more than a nominal portion of the cost of our products.

We intend to rely upon licensees, strategic partners or third party marketing and distribution partners to provide a significant part of our marketing and sales functions. Should these outside parties fail to perform as expected, we will need to develop or procure other marketing and distribution channels, which would cause delays or interruptions in our product supply and result in the loss of significant sales or customers.

We currently have no internal sales, marketing and distribution capabilities, and will rely extensively on third-party licensees, strategic partners or third party marketing and distribution companies to perform a significant part of those functions. As a consequence of that reliance, our ability to effectively market and distribute our products will be dependent in large part on the strength and financial condition of others, the expertise and relationships of those third-parties with customers, and the interest of those parties in selling and marketing our products. Prospective third-party licensees, strategic partners and marketing and distribution parties may also market and distribute the products of other companies. If our relationships with any third-party licensees, strategic partners or marketing and distribution partners were to terminate, we would need to either develop alternative relationships or develop our own internal sales and marketing forces to continue to sell our products. Even if we are able to develop our internal sales, marketing and distribution capabilities, these efforts would require significant cash and other resources that would be diverted from other uses, if available at all, and could cause delays or interruptions in our product supply to customers, which could result in the loss of significant sales or customers. We can give you no assurance that we will be successful in our efforts to engage licensees, strategic partners or third party marketing and distribution companies to meet our sales, marketing and distribution requirements.

We intend to rely upon the third-party FDA-approved manufacturers or suppliers to manufacture our heart monitoring products. Should these manufacturers fail to perform as expected, we will need to develop or procure other manufacturing sources, which would cause delays or interruptions in our product supply and result in the loss of significant sales and customers.

We currently have no internal manufacturing capability, and will rely extensively on FDA-approved licensees, strategic partners or third party contract manufacturers or suppliers. Should we be forced to manufacture our products, we cannot give you any assurance that we will be able to develop an internal manufacturing capability or procure third party suppliers. Moreover, we cannot give you any assurance that any contract manufacturers or suppliers we procure will be able to supply our product in a timely or cost effective manner or in accordance with applicable regulatory requirements or our specifications.

We are dependent for our success on a few key executive officers. Were we to lose one or more of these key executive officers, we would be forced to expend significant time and money in the pursuit of a replacement, which would result in both a delay in the implementation of our business plan and the diversion of working capital.

Our success depends to a critical extent on the continued efforts of services of our Chief Executive Officer, Mr. Marvin H. Fink, and our Vice President and Chief Technology Officer, Dr. Budimir S. Drakulic. Were we to lose one or more of these key executive officers, we would be forced to expend significant time and money in the pursuit of a replacement, which would result in both a delay in the implementation of our business plan and the diversion of working capital. We can give you no assurance that we can find satisfactory replacements for these key executive officers at all, or on terms that are not unduly expensive or burdensome to our company. Although Mr. Fink has signed an employment agreement pursuant to which he will provide continued services to the company until October 12, 2006, and Dr. Drakulic is employed as a consultant under a loan-out agreement through October 15, 2012, these agreements will not preclude either of these key officers from leaving the company. We currently maintain key man life insurance policies in the amount of \$1 million with respect to Mr. Fink and \$3 million with respect to Dr. Drakulic which will assist us in recouping some of our costs in the event of the death of those officers.

Our inability to protect our intellectual property rights could allow competitors to use our property rights and technologies in competition against our company, which would reduce our sales. In such an event we would not be able to grow as quickly as expected, and the loss of anticipated revenues will also reduce our ability to fully fund our operations and to otherwise execute our business plan.

We rely on a combination of patent, patent pending, copyright, trademark and trade secret laws, proprietary rights agreements and non-disclosure agreements to protect our intellectual properties. We cannot give you any assurance that these measures will prove to be effective in protecting our intellectual properties. We also cannot give you any assurance that our existing patents will not be invalidated, that any patents that we currently or prospectively apply for will be granted, or that any of these patents will ultimately provide significant commercial benefits. Further, competing companies may circumvent any patents that we may hold by developing products which closely emulate but do not infringe our patents. While we intend to seek patent protection for our products in selected foreign countries, those patents may not receive the same degree of protection as they would in the United States. We can give you no assurance that we will be able to successfully defend our patents and proprietary rights in any action we may file for patent infringement. Similarly, we can give you any assurance that we will not be required to defend against litigation involving the patents or proprietary rights of others, or that we will be able to obtain licenses for these rights. Legal and accounting costs relating to prosecuting or defending patent infringement litigation may be substantial.

We also rely on proprietary designs, technologies, processes and know-how not eligible for patent protection. We cannot give you any assurance that our competitors will not independently develop the same or superior designs, technologies, processes and know-how.

While we have and will continue to enter into proprietary rights agreements with our employees and third parties giving us proprietary rights to certain technology developed by those employees or parties while engaged by our company, we can give you no assurance that courts of competent jurisdiction will enforce those agreements.

Risks Relating To An Investment In Our Securities

Our common shares are sporadically or thinly traded, so you may be unable to sell at or near ask prices or at all if you need to sell your shares to raise money or otherwise desire to liquidate your shares

Our common shares have historically been sporadically or thinly traded on the OTCBB, meaning that the number of persons interested in purchasing our common shares at or near ask prices at any given time may be relatively small or non-existent. This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an unproven development stage company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without a material reduction in share price. We cannot give you any assurance that a broader or more active public trading market for our common shares will develop or be sustained, or that current trading levels will be sustained. Due to these conditions, we can give you no assurance that you will be able to sell your shares at or near ask prices or at all if you need money or otherwise desire to liquidate your shares.

The market price for our common shares is particularly volatile given our status as a relatively unknown development stage company with a small and thinly-traded public float, limited operating history and lack of revenues or profits to date for our newly introduced products, which could lead to wide fluctuations in our share price. The price at which you purchase our common shares may not be indicative of the price that will prevail in the trading market. You may be unable to sell your common shares at or above your purchase price, which may result in substantial losses to you. The volatility in our common share price may subject us to securities litigation.

The market for our common shares is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. The volatility in our share price is attributable to a number of factors. First, we have relatively few common shares outstanding in the public float since most of our shares are held by a small number of shareholders. In addition, as noted above, our common shares are sporadically or thinly traded. As a consequence of this lack of liquidity, the trading of relatively small quantities of shares by our shareholders may disproportionately influence the price of those shares in either direction. The price for our shares could, for example, decline precipitously in the event that a large number of our common shares are sold on the market without commensurate demand, as compared to a seasoned issuer which could better absorb those sales without a material reduction in share price. Secondly, we are a speculative or risky investment due to our limited operating history and lack of revenues or profits to date, and uncertainty of future market acceptance for our products. As a consequence of this enhanced risk, more risk-averse investors may, under the fear of losing all or most of their investment in the event of negative news or lack of progress, be more inclined to sell their shares on the market more quickly and at greater discounts than would be the case with the stock of a seasoned issuer. Additionally, in the past, plaintiffs have often initiated securities class action litigation against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and liabilities and could divert management's attention and resources.

The following factors may add to the volatility in the price of our common shares: actual or anticipated variations in our quarterly or annual operating results; acceptance of our products and services as viable security and technology solutions; government regulations, announcements of significant acquisitions, strategic partnerships or joint ventures; our capital commitments; and additions or departures of our key personnel. Many of these factors are beyond our control and may decrease the market price of our common shares, regardless of our operating performance. We cannot

make any predictions or projections as to what the prevailing market price for our common shares will be at any time, including as to whether our common shares will sustain their current market prices, or as to what effect that the sale of shares or the availability of common shares for sale at any time will have on the prevailing market price.

Since a single shareholder currently beneficially owns the majority of our outstanding common shares, that single shareholder will retain the ability to control our management and the outcome of corporate actions requiring shareholder approval notwithstanding the overall opposition of our other shareholders. This concentration of ownership could discourage or prevent a potential takeover of our company that might otherwise result in you receiving a premium over the market price for your common shares.

ARC Finance Group, LLC, which is owned and controlled by Ms. Tracey Hampton, owns 65.8% of our outstanding common shares. As a consequence of its controlling stock ownership position, ARC Finance Group will retain the ability to elect a majority of our board of directors, and thereby control our management. ARC Finance Group also has the ability to control the outcome of corporate actions requiring shareholder approval, including mergers and other changes of corporate control, going private transactions, and other extraordinary transactions.

A large number of common shares are issuable upon conversion of our series A preferred shares or the exercise of outstanding common share purchase options or warrants. The conversion or exercise of these securities could result in the substantial dilution of your investment in terms of your percentage ownership in the company as well as the book value of your common shares. The sale of a large amount of common shares received upon the conversion or exercise of these securities on the public market to finance the exercise price or to pay associated income taxes, or the perception that such sales could occur, could substantially depress the prevailing market prices for our shares.

There are currently outstanding as of January 6, 2005, 377,719 series A preferred shares each convertible into one common share at the conversion rate of \$3 per share, and common share purchase options and warrants entitling the holders to purchase 4,681,395 common shares at a weighted average exercise price of \$2.30 per share, including a number granted to directors, officers, employees and consultants that are subject to vesting conditions. In the event of the conversion or exercise of these securities, you could suffer substantial dilution of your investment in terms of your percentage ownership in the company as well as the book value of your common shares. In addition, the holders of the common share purchase options or warrants may sell common shares in tandem with their exercise of those options or warrants to finance that exercise, or may resell the shares purchased in order to cover any income tax liabilities that may arise from their conversion or exercise of these securities.

Our issuance of additional common shares or preferred shares, or options or warrants to purchase those shares, would dilute your proportionate ownership and voting rights. Our issuance of additional preferred shares, or options or warrants to purchase those shares, could negatively impact the value of your investment in our common shares as the result of preferential voting rights or veto powers, dividend rights, disproportionate rights to appoint directors to our board, conversion rights, redemption rights and liquidation provisions granted to the preferred shareholders, including the grant of rights that could discourage or prevent the distribution of dividends to you, or prevent the sale of our assets or a potential takeover of our company that might otherwise result in you receiving a distribution or a premium over the market price for your common shares.

We are entitled under our certificate of incorporation to issue up to 100,000,000 common and 10,000,000 blank check preferred shares. After taking into consideration our outstanding common and preferred shares as of January 6, 2005, we will be entitled to issue up to 65,139,932 additional common shares and 9,622,281 additional preferred shares. Our board may generally issue those common and preferred shares, or options or warrants to purchase those shares, without further approval by our shareholders based upon such factors as our board of directors may deem relevant at that time. Any preferred shares we may issue shall have such rights, preferences, privileges and restrictions as may be designated from time-to-time by our board, including preferential dividend rights, voting rights, conversion rights, redemption rights and liquidation provisions. It is likely that we will be required to issue a large amount of additional securities to raise capital to further our development and marketing plans. It is also likely that we will be required to issue a large amount of additional securities to directors, officers, employees and consultants as compensatory grants

in connection with their services, both in the form of stand-alone grants or under our various stock plans. We cannot give you any assurance that we will not issue additional common or preferred shares, or options or warrants to purchase those shares, under circumstances we may deem appropriate at the time.

FORWARD-LOOKING STATEMENTS

In this prospectus we make a number of statements, referred to as *forward-looking statements*, which are intended to convey our expectations or predictions regarding the occurrence of possible future events or the existence of trends and factors that may impact our future plans and operating results. These forward-looking statements are derived, in part, from various assumptions and analyses we have made in the context of our current business plan and information currently available to us and in light of our experience and perceptions of historical trends, current conditions and expected future developments and other factors we believe to be appropriate in the circumstances. You can generally identify forward-looking statements through words and phrases such as *seek*, *anticipate*, *believe*, *estimate*, *expect*, *intend*, *plan*, *budget*, *project*, *maybe*, *may continue*, and similar expressions. When reading any forward looking statement you should remain mindful that actual results or developments may vary substantially from those expected as expressed in or implied by that statement for a number of reasons or factors, such as those relating to:

- the success of our research and development activities, the development of a viable commercial production model, and the speed with which regulatory authorizations and product launches may be achieved;
- whether or not a market for our products develops and, if a market develops, the pace at which it develops;
 - our ability to successfully sell our products if a market develops;
 - our ability to attract the qualified personnel to implement our growth strategies;
 - our ability to develop sales, marketing and distribution capabilities;
- our ability to obtain reimbursement from third party payers for the products that we sell;
 - the accuracy of our estimates and projections;
 - our ability to fund our short-term and long-term financing needs;
 - changes in our business plan and corporate strategies; and